

APPENDIX F

TEXT OF FEDERAL SECURITIES LAWS REGARDING THE BOOKS AND RECORDS PROVISIONS

Section 10A of the Securities Exchange Act of 1934 appears in full below. Following Section 10A are excerpts from other relevant sections of the Exchange Act and relevant sections of GAAS.

SECTION 10A

- (a) *In General* - Each audit required pursuant to this title of the financial statements of an issuer by an independent public accountant shall include, in accordance with generally accepted auditing standards, as may be modified or supplemented from time to time by the Commission -
 - (1) procedures designed to provide reasonable assurance of detecting illegal acts that would have a direct and material effect on the determination of financial statement amounts;
 - (2) procedures designed to identify related party transactions that are material to the financial statements or otherwise require disclosure therein; and
 - (3) an evaluation of whether there is substantial doubt about the ability of the issuer to continue as a going concern during the ensuing fiscal year.
- (b) *Required Response to Audit Discoveries*
 - (1) Investigation and Report to Management - If, in the course of conducting an audit pursuant to this title to which subsection (a) applies, the independent public accountant detects or otherwise becomes aware of information indicating that an illegal act (whether or not perceived to have a material effect on the financial statements of the issuer) has or may have occurred, the accountant shall, in accordance with generally accepted auditing standards, as may be modified or supplemented from time to time by the Commission -
 - (A) (i) determine whether it is likely that an illegal act has occurred; and
 - (ii) if so, determine and consider the possible effect of the illegal act on the financial statements of the issuer, including any contingent monetary effects, such as fines, penalties, and damages; and
 - (B) as soon as practicable, inform the appropriate level of the management of the issuer and assure that the audit committee of the issuer, or the board of directors of the issuer in the absence of such a committee, is adequately informed with respect to illegal acts that have been detected or have

otherwise come to the attention of such accountant in the course of the audit, unless the illegal act is clearly inconsequential.

- (2) Response to Failure to take Remedial Action - If, after determining that the audit committee of the board of directors of the issuer, or the board of directors of the issuer in the absence of an audit committee, is adequately informed with respect to illegal acts that have been detected or have otherwise come to the attention of the accountant in the course of the audit of such accountant, the independent public accountant concludes that -

- (A) the illegal act has a material effect on the financial statements of the issuer;
- (B) the senior management has not taken, and the board of directors has not caused senior management to take, timely and appropriate remedial actions with respect to the illegal act; and
- (C) the failure to take remedial action is reasonably expected to warrant departure from a standard report of the auditor, when made, or warrant resignation from the audit engagement;

the independent public accountant shall, as soon as practicable, directly report its conclusions to the board of directors.

- (3) Notice to Commission; Response to Failure to Notify - An issuer whose board of directors receives a report under paragraph (2) shall inform the Commission by notice no later than 1 business day after the receipt of such report and shall furnish the independent public accountant making such report with a copy of the notice furnished to the Commission. If the independent public accountant fails to receive a copy of the notice before the expiration of the required 1-business-day period, the independent public accountant shall -

- (A) resign from the engagement; or
- (B) furnish to the Commission a copy of its report (or the documentation of any oral report given) not later than 1 business day following such failure to receive notice.

- (4) Report after Resignation - If an independent public accountant resigns from an engagement under paragraph (3)(A), the accountant shall, not later than 1 business day following the failure by the issuer to notify the Commission under paragraph (3), furnish to the Commission a copy of the accountant's report (or the documentation of any oral report given).

- (c) *Auditor Liability Limitation* - No independent public accountant shall be liable in a private action for any finding, conclusion, or statement expressed in a report made pursuant to paragraph (3) or (4) of subsection (b), including any rule promulgated pursuant thereto.
- (d) *Civil Penalties in Cease-And-Desist Proceedings* - If the Commission finds, after notice and opportunity for hearing in a proceeding instituted pursuant to section 21C, that an independent public accountant has willfully violated paragraph (3) or (4) of subsection (b), the Commission may, in addition to entering an order under section 21C, impose a civil penalty against the independent public accountant and any other person that the Commission finds was a cause of such violation. The determination to impose a civil penalty and the amount of the penalty shall be governed by the standards set forth in section 21B.
- (e) *Preservation of Existing Authority* - Except as provided in subsection (d), nothing in this section shall be held to limit or otherwise affect that authority of the Commission under this title.
- (f) *Definition* - As used in this section, the term ‘illegal act’ means an act or omission that violates any law, or any rule or regulation having the force of law.



EXCHANGE ACT, SECTION 13(b)(excerpts)

- (2) Every issuer which has a class of securities registered pursuant to section 12 of this title and every issuer which is required to file reports pursuant to section 15(d) of this title shall -
 - (A) make and keep books, records, and accounts, which, in reasonable detail, accurately and fairly reflect the transactions and dispositions of the assets of the issuer; and
 - (B) devise and maintain a system of internal accounting controls sufficient to provide reasonable assurances that -
 - (i) transactions are executed in accordance with management’s general or specific authorization;
 - (ii) transactions are recorded as necessary (I) to permit preparation of financial statements in conformity with generally accepted accounting principles or any other criteria applicable to such statements, and (II) to maintain accountability for assets;
 - (iii) access to assets is permitted only in accordance with management’s general or specific authorization; and

- (iv) the recorded accountability for assets is compared with the existing assets at reasonable intervals and appropriate action is taken with respect to any differences.

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- (5) No person shall knowingly circumvent or knowingly fail to implement a system of internal accounting controls or knowingly falsify any book, record, or account described in paragraph (2).

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Securities Exchange Act of 1934 Rules (17 CFR 240.13b2-1 and 13b2-2)

Rule 13b2-1.

No person shall, directly or indirectly, falsify or cause to be falsified, any book, record or account subject to Section 13(b)(2)(A) of the Securities Exchange Act.

Rule 13b2-2.

No director or officer of an issuer shall, directly or indirectly,

- (a) make or cause to be made a materially false or misleading statement, or
- (b) omit to state, or cause another person to omit to state, any material fact necessary in order to make statements made, in light of the circumstances under which such statements were made, not misleading to an accountant in connection with (1) any audit or examination of the financial statements of the issuer required to be made pursuant to this subpart or (2) the preparation or filing of any document or report required to be filed with the Commission pursuant to this subpart or otherwise.

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Excerpts of GAAS, AU Section 317,

Illegal Acts by Clients:

- .02 The term *illegal acts*, for purposes of this section, refers to violations of laws or governmental regulations. Illegal acts by clients are acts attributable to the entity whose financial statements are under audit or acts by management or employees acting on behalf of the entity . . .

- .03 Whether an act is, in fact, illegal is a determination that is normally beyond the auditor's professional competence. . . . The determination as to whether a particular act is illegal would generally be based on the advice of an informed expert qualified to practice law or may have to await final determination by a court of law. . . .
- .05 The auditor considers laws and regulations that are generally recognized by auditors to have a direct and material effect on the determination of financial statement amounts. . . .

Audit Procedures in the Absence of Evidence Concerning Possible Illegal Acts

- .08 Normally, an audit in accordance with generally accepted auditing standards does not include audit procedures specifically designed to detect illegal acts. However, procedures applied for the purpose of forming an opinion on the financial statements may bring possible illegal acts to the auditor's attention. The auditor should make inquiries of management concerning the client's compliance with laws and regulations. The auditor also ordinarily obtains written representations from management concerning the absence of violations or possible violations of laws or regulations whose effects should be considered for disclosure in the financial statements or as a basis for recording a loss contingency. The auditor need perform no further procedures in this area absent specific information concerning possible illegal acts. . . .

Audit Procedures in Response to Possible Illegal Acts

- .10 When the auditor becomes aware of information concerning a possible illegal act, the auditor should obtain an understanding of the nature of the act, the circumstances in which it occurred, and sufficient other information to evaluate the effect on the financial statements. . . .
- .13 In evaluating the materiality of an illegal act that comes to his attention, the auditor should consider both the quantitative and qualitative materiality of the act. . . .
- .16 The auditor should consider the implications of an illegal act in relation to other aspects of the audit, particularly the reliability of representations of management. . . .
- .17 The auditor should assure himself that the audit committee, or others with equivalent authority and responsibility, is adequately informed with respect to illegal acts that come to the auditor's attention. . . .

Other Considerations in an Audit in Accordance With GAAS

- .22 In addition to the need to withdraw from the engagement, as described in paragraph .20, the auditor may conclude that withdrawal is necessary when the client does not take the remedial

action that the auditor considers necessary in the circumstances even when the illegal act is not material to the financial statements. . . .

.23 Disclosure of an illegal act to parties other than the client's senior management and its audit committee or board of directors is not ordinarily part of the auditor's responsibility, and such disclosure would be precluded by the auditor's ethical or legal obligation of confidentiality, unless the matter affects his opinion on the financial statements. The auditor should recognize, however, that in the following circumstances a duty to notify parties outside the client may exist:

- a. When the entity reports an auditor change under the appropriate securities law on Form 8-K
- b. To a successor auditor when the successor makes inquiries in accordance with section 315, *Communications Between Predecessor and Successor Auditors*
- c. In response to a subpoena
- d. To a funding agency or other specified agency in accordance with requirements for the audits of entities that receive financial assistance from a government agency

Because potential conflicts with the auditor's ethical and legal obligations for confidentiality may be complex, the auditor may wish to consult with legal counsel before discussing illegal acts with parties outside the client. . . .



Excerpts of GAAS, AU Section 325 Communication of Internal Control Structure Related Matters Noted in an Audit:

.02 During the course of an audit, the auditor may become aware of matters relating to the internal control structure that may be of interest to the audit committee. The matters that this section requires for reporting to the audit committee are referred to as *reportable conditions*. Specifically, these are matters coming to the auditor's attention that, in his judgment, should be communicated to the audit committee because they represent significant deficiencies in the design or operation of the internal control structure, which could adversely affect the organization's ability to record, process, summarize, and report financial data consistent with the assertions of management in the financial statements. Such deficiencies may involve aspects of the internal control structure elements of (a) the control environment, (b) the accounting system, or (c) control procedures. . . .

.04 . . . The auditor is not obligated to search for reportable conditions. However, the auditor may become aware of possible reportable conditions through consideration of the elements

of the internal control structure, application of audit procedures to balances and transactions, or otherwise during the course of the audit.

Appendix - Examples of Possible Reportable Conditions [not all examples are listed]

- Inadequate provisions for the safeguarding of assets
- Evidence of failure to safeguard assets from loss, damage or misappropriation
- Evidence of willful wrongdoing by employees or management
- Evidence of manipulation, falsification, or alteration of accounting records or supporting documents
- Evidence of misrepresentation by client personnel to the auditor